In the United States Court of Appeals for the Ninth Circuit

No. 11909

Hawaiian Trust Company, Limited, *Executor of the Will of Laura D. Sherman, Appellant*

v.

Agnes M. Kanne, *Executrix under the Will of Fred H. Kanne, Deceased, Appellee*

On Appeal from the District Court of the United States for the Territory of Hawaii

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BRIEF FOR THE APPELLEE

FILED

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BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion of the District Court (R. 41-51) is reported in 76 F. Supp. 224.

JURISDICTION

This appeal involves federal income taxes for the calendar years 1940 and 1941. The taxes in dispute were paid by Laura D. Sherman, the taxpayer, as follows: $4,274.57 with respect to the taxable year 1940, in installments of $1,068.65 on March 15, 1941, $1,068.65 on June 14, 1941, $1,068.64 on September 12, 1941, and $1,068.63 on December 12, 1941 (R. 47); and $6,046.15 with respect to the taxable year 1941, in installments of

$1,511.54 on March 16, 1942, $1,511.54 on June 13, 1942, $1,511.54 on September 14, 1942, and $1,511.53 on December 15, 1942 (R. 48).* Claim for refund of $969.65 of the 1940 income tax and claim for refund of $1,434.81 of the 1941 income tax were filed on March 14, 1944, by Laura D. Sherman, since deceased, and rejected. (R. 48-49.) Within the time provided in Section 3772 of the Internal Revenue Code and on October 30, 1945, the taxpayer brought an action in the District Court for recovery of the taxes alleged to have been overpaid as stated in the claims for refund. (R. 2, 9, 10.) Jurisdiction was conferred on the District Court by Section 24, subsections Fifth and Twentieth of the Judicial Code, as amended. The judgment was entered on February 18, 1948, in favor of the Collector, dismissing the appellant's action with costs. (R. 52-53.) Thereafter, within three months the appellant's notice of appeal was filed on March 17, 1948. (R. 55.) The jurisdiction of this Court is invoked under the provisions of 28 U. S. C., Sec. 1291.

QUESTION PRESENTED

Whether Laura D. Sherman, life beneficiary of an *inter vivos* trust created by her husband in 1935, is taxable on that part of the income thereof in the years 1940 and 1941 which was paid to her son's divorced wife for her support and the support of her two minor children in accordance with irrevocable assignments executed by Mrs. Sherman in 1936.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and Regulations involved will be found in the Appendix, *infra*.

* Thereafter, on August 5, 1944, Mrs. Sherman paid to Collector Kanne a deficiency of $90 in income tax for the year 1941, plus interest thereon of $12.91, or a total of $102.91, which is not involved in this controversy. (R. 48.)

STATEMENT

The pertinent facts, sufficient for the purposes herein, were found by the District Court substantially as follows (R. 41-49): Laura D. Sherman, now deceased, a resident of the Territory of Hawaii, brought this action to recover federal income taxes for the calendar years 1940 and 1941 alleged to have been illegally assessed and collected by Fred H. Kanne, now deceased, who was then the Collector of Internal Revenue for the District of Hawaii. Laura D. Sherman died on June 11, 1947. The Hawaiian Trust Company, Limited, of Honolulu, having qualified and been confirmed as executor of her will on July 15, 1947, was substituted as plaintiff appellant herein on July 22, 1947. (R. 36-38.) Fred H. Kanne died on December 24, 1946. His widow, Agnes M. Kanne, of Honolulu, having qualified and been confirmed as executrix of his will on February 4, 1947, was substituted as defendant appellee herein on March 6, 1947. (R. 34-36, 49.)

The facts were stipulated and admitted into evidence except those facts stated in the supplementary stipulation relating to the life expectancy of Anna Adams Nott, Frederick Dickson K. Nott, Gretchen K. Nott, and Laura D. Sherman, which were not admitted in evidence, on the ground that such information was wholly immaterial in the case. (R. 41.)

The deceased taxpayer, Laura D. Sherman, was the sole life beneficiary and co-trustee of an irrevocable *inter vivos* trust created by her husband on December 26, 1935, in which it was provided that all of the net income derived from the trust estate should be paid to her during her lifetime. (R. 42.)

In anticipation of the divorce of her son, Frederick Dickson Nott, from his wife, Anna Adams Nott, which was accomplished by a decree of divorce entered on *April 28, 1936,* Laura D. Sherman, by separate docu-

ments each dated *April 16, 1936,* made assignments of $100 a month to Anna Adams Nott until death or remarriage, whichever is earlier, and $75 a month for each of the minor children until the respective child's death or majority, whichever is earlier, out of the income to which she (Laura D. Sherman) was entitled from the trust set up by her husband. (R. 42-43.) These assignments of income were made because Frederick Dickson Nott, the taxpayer's son, did not have sufficient income himself to pay the amounts awarded in the divorce decree which had ordered alimony of $100 a month to his divorced wife so long as she should remain unmarried, and in addition $75 a month each for the support and maintenance of his two minor children until the minors should have respectively attained their majorities. Laura D. Sherman was prompted to make these assignments of income by a desire to assist her son financially and not for tax-avoidance purposes. (R. 42, 45-46.)

The pertinent part of the assignment to Anna Adams Nott read as follows (R. 43-44):

> Now Therefore the premises considered, the undersigned, Laura D. Sherman, hereinafter referred to as the assignor, does hereby assign, transfer and set over unto Anna Adams Nott, hereinafter referred to as the assignee, the sum of One Hundred Dollars ($100.00) a month from the income to which the assignor now is or shall be entitled to receive as life beneficiary under the terms and provisions of that certain unrecorded trust deed dated December 26, 1935, executed by George Sherman as settlor and the assignor and Hawaiian Trust Company, Limited, an Hawaiian corporation, as trustees, until the death or remarriage of the assignee whichever event shall first occur and upon the occurrence of either of said

events this assignment shall become inoperative and shall be of no further force or effect.

The Hawaiian Trust Company, Limited, co-trustee under said trust deed, is hereby empowered and directed to pay from the assignor's income, as aforesaid, the sum of One Hundred Dollars ($100.00) a month to the said assignee, the first of such payments to be made on the 1st day of May, 1936, and a like sum on the 1st day of each and every month thereafter until the death or remarriage of said assignee, whichever event shall first occur, and upon the occurrence of either of such events of which said Hawaiian Trust Company, Limited, shall have strict and exact proof, all payments shall cease and determine.

The pertinent part of the assignments for each of the minor children read as follows (R. 44-45):

Now Therefore in consideration of the premises and of the promise of the assignee hereinafter contained the assignor does hereby assign, transfer and set over unto the assignee the sum of Seventy-Five Dollars ($75.00) a month from the income to which the assignor now is or shall be entitled to receive as life beneficiary under the terms and provisions of that certain unrecorded trust deed dated December 26, 1935, executed by George Sherman as settlor and the assignor and Hawaiian Trust Company, Limited, an Hawaiian corporation, as trustees, which sum is to be used by the assignee solely for the support, education and maintenance of said minor during his minority provided, however, and this assignment is upon this express condition, that upon the occurrence of any of the following events this assignment shall become

inoperative and all payments authorized to be made herein shall cease and determine, such events being:

(1) Upon the death of said minor or the assignee;

(2) Upon the said minor attaining his majority under the laws of the jurisdiction in which said minor is then living;

The Hawaiian Trust Company, Limited, co-trustee under said trust deed, is hereby empowered and directed to pay from the assignor's income, as aforesaid, the sum of Seventy-Five Dollars ($75.00) a month to the said assignee, the first of such payments to be made on the 1st day of May, 1936, and a like sum on the 1st day of each and every month thereafter until the occurrence of any one or more of the above mentioned events and upon the occurrence of any of such events (of which said Hawaiian Trust Company, Limited, shall have strict and exact proof) all payments shall cease and determine.

On April 16, 1936, the date of the assignments, Frederick Dickson K. Nott was approximately ten years of age, Gretchen K. Nott was approximately nine years of age, Anna Adams Nott was approximately thirty-five years of age, and Laura D. Sherman was approximately sixty-seven years of age. (R. 46.)

Pursuant to the assignments, the trustees of the Sherman trust paid out of the net income thereof to Anna Adams Nott the total sum of $1,200 during each of the calendar years 1940 and 1941 for her support, and also paid out of the net income of the trust to Anna Adams Nott an additional total sum of $1,800 during each of the calendar years 1940 and 1941 for the support and maintenance of her two minor children. (R. 46.)

Anna Adams Nott and her two children, Frederick Dickson K. Nott and Gretchen K. Nott, are presently surviving and reside in the State of Washington where they have resided since 1942. Prior to April 16, 1936, these individuals each resided in Hawaii until December 5, 1941, when they departed from Hawaii for the State of Washington. Under the laws of the Territory of Hawaii the age of majority is twenty years, whereas under the laws of the State of Washington the age of majority is twenty-one years . (R. 47.)

During the calendar year 1940 the trustees of the Sherman trust paid to Laura D. Sherman the total sum of $6,332.42 of the net income of the trust estate, and she included in her federal income tax return for that year the sum of $9,332.40, representing the entire amount of the net income of the trust for that year. During the calendar year 1941, the trustees paid Laura D. Sherman the total sum of $7,598.98 of the net income of the trust estate, and she included in her federal income tax return for that year $10,598.98, representing the entire amount of the net income of the trust for that year. (R. 42, 47, 48.)

The District Court held that the gifts of income made by the three assignments dated April 16, 1936, to the taxpayer's daughter-in-law and grandchildren, while substantial in amounts, were, respectively, upon the happening of any one of the conditions provided in the assignments brought to an end, and the respective assignment thereupon terminated, and that Laura D. Sherman, the assignor taxpayer, retained the *entire* reversionary interest in the income so assigned, which reversion, representing as it does, a substantial economic interest in the Sherman trust dated December 26, 1935, definitely requires the inclusion of the assigned income as part of the taxable gross income of the assignor under the provisions of Section 22(a) of

the Internal Revenue Code and the applicable Treasury Regulations promulgated thereunder, and brings the taxability of such assigned income within the rationale of the Supreme Court's opinion in the case of *Harrison* v. *Schaffner*, 312 U. S. 579, and excludes it from the rationale of that Court's opinion in the case of *Blair* v. *Commissioner,* 300 U. S. 5, relied upon by the taxpayer. (R. 50.)

SUMMARY OF ARGUMENT

This case is ruled by *Harrison* v. *Schaffner,* 312 U. S. 579. Without relinquishing her life estate, the taxpayer simply deflected part of her income therefrom for a short period not co-extensive with her life to her former daughter-in-law and grandchildren. The *Schaffner* case and the cases of *Helvering* v. *Horst,* 311 U. S. 112, and *Helvering* v. *Eubank,* 311 U. S. 122, as well as other decisions of the Supreme Court, make it clear that such an assignment does not relieve the assignor of tax liability. *Blair* v. *Commissioner,* 300 U. S. 5, is not opposed. There the owner of a life estate assigned *for the duration of his life* a specified portion of the income to which he was entitled, and the Supreme Court held he was not taxable on the income thus paid to the assignees. But the decision in this case rested on the theory that the assignor had disposed, not merely of his right to income, but also of his *entire* life interest. If the *Blair* case be regarded as standing for more than this, it would be inconsistent with other cases involving assignments of income. Thus, if the taxpayer in the *Horst* case, *supra,* had transferred the bonds in trust for himself, and then assigned a portion of the income therefrom to his son for a short period, it could be argued that the *Blair* case would not have required a different result. But since there is no magic in the trust device, the crucial issue is whether the taxpayer had parted with an underlying interest out of which

the income flowed. The taxpayer here, unlike the assignor in the *Blair* case, did not part with her underlying property interest, i. e., her life estate, and therefore continued to remain liable with respect to the entire trust net income whether it was actually received by her or deflected to the assignees. In substance, the assignments are powers of attorneys to receive the income to which the taxpayer "now is or shall be entitled to receive." When the assignees collect under these instruments, they do not collect their own income. By the terms of the instruments they are to collect the income due to the taxpayer.

ARGUMENT

The Life Beneficiary Remained Taxable with Respect to the Assigned Income

A. The assignments were of future income only, and the assignor's reversionary interest constituted a substantial economic interest in the trust

The taxpayer was a life beneficiary of a trust. Without in any way relinquishing her life interest therein, she carved out a portion of the yearly income thereof to which she was entitled and directed the trustees of that trust (of which she was also a co-trustee) to pay to Anna Adams Nott for her support and the support of the taxpayer's minor grandchildren stated amounts monthly out of the income until the happening of any one of the conditions provided in the assignments, whereupon the assignments terminated. Thus she retained the entire reversionary interest in the income so assigned upon the happening of the conditions which terminated the assignments. Accordingly, we submit that the assignments did not effectively relieve the assignor of liability for the tax on such assigned income.

Like the owner of the coupon bonds in *Helvering* v. *Horst,* 311 U. S. 112, the taxpayer in the instant case

simply reallocated a portion of her future income within the family group without relinquishing her interest in the underlying trust estate from which the income was separated. In the *Horst* case the property was bonds; here the property was a life estate in a trust. We believe there are no essential differences in the two cases.

The rule in the *Horst* case and its companion case of *Helvering* v. *Eubank,* 311 U. S. 122, followed established principles. See *Lucas* v. *Earl,* 281 U. S. 111; *Burnet* v. *Leininger,* 285 U. S. 136; *Helvering* v. *Clifford,* 309 U. S. 331; *Reinecke* v. *Smith,* 289 U. S. 172, 177; *Harrison* v. *Schaffner,* 312 U. S. 579. Cf. *Corliss* v. *Bowers,* 281 U. S. 376; *DuPont* v. *Commissioner,* 289 U. S. 685; *Burnet* v. *Wells,* 289 U. S. 670. And the facts in the instant case make the application of these principles particularly appropriate here, especially the rule laid down in the *Schaffner* case.

In every real sense, we believe the taxpayer here exercised control over the flow of the income in question. She directed the trustees of the Sherman trust, of which she was both a co-trustee and the sole beneficiary, to pay from her income stated amounts each month to her daughter-in-law for her daughter-in-law's support and for the support of her grandchildren until the occurrence of designated events, all of which could have happened before the taxpayer's death, and upon the happening of any one of which events, all payments of income to the particular assignee were to cease and terminate. Thus, Laura D. Sherman, as assignor, retained the entire reversionary interest in the income so assigned.

Not only did she retain such interest in the income, but as co-trustee with the Hawaiian Trust Company, the appellant herein, Mrs. Sherman had power under paragraph 5 of the Sherman trust indenture (R. 15-16) to manage and control the property included in the trust

estate, to sell it, to exchange it, and to reinvest the proceeds of the sale thereof. Thus, by manipulating the disposition of the trust estate, the trustees could effectively limit the income thereof, and if for some reason the income of the trust dropped below the $3,000 payable to the assignees pursuant to the assignments of Laura D. Sherman, the assignees were without recourse to require the trustees of the Sherman trust to invade principal to make up any deficiency in income or change the trust investments. Moreover, paragraph 13 of the trust deed (R. 18) clearly shows that it was the settlor's intention that his wife, Laura D. Sherman, should not have any interest whatsoever in the principal of the trust estate. That paragraph of the trust indenture provides that no amendment thereof shall authorize the payment or application of any part of the principal of the trust estate to or for the benefit of the settlor's wife, Laura D. Sherman. We think these circumstances demonstrate that the assignees acquired no interest in the principal of the trust, but merely a right to receive a share of the income, if any, up to $3,000 a year until the happening of the events which terminated their interest in the income thereof.

We think the present case is controlled by *Harrison* v. *Schaffner, supra,* where the life beneficiary of a trust assigned to her children specified amounts in dollars from the income of the trust for the year following the assignment, and repeated the ritual the following year. The respondent in that case rested his case on technical distinctions affecting the conveyancing of equitable interests (pp. 580-581) arguing that by the assignment of trust income, the assignee acquires an equitable right to an accounting by the trustee which, for many purposes, is treated by courts of equity as a present equitable estate in the trust property so that each assignee is a donee of an interest in the trust property for the term

of the assignment, and thus the recipient of income from his own property which is taxable to him rather than to the donor. But the Supreme Court in the *Schaffner* case remarked as it had theretofore done in *Lucas* v. *Earl,* 281 U. S. 111, 114, that the operation of the statutes taxing income is not dependent upon such attenuated subtleties, and proceeded to decide the issue in accordance with the reasoning of its opinions in *Corliss* v. *Bowers, supra; Lucas* v. *Earl, supra, Helvering* v. *Horst, supra; Helvering* v. *Eubank, supra,* and *Helvering* v. *Clifford, supra,* stating that these decisions were controlling in the *Schaffner* case. Distinguishing *Blair* v. *Commissioner,* 300 U. S. 5, upon which the taxpayer relied, the Court said (pp. 582-583):

> We think that the gift by a beneficiary of a trust of some part of the income derived from the trust property for the period of a day, a month or a year involves no * * * substantial disposition of the trust property as to camouflage the reality that he is enjoying the benefit of the income from the trust of which he continues to be the beneficiary, * * *. Even though the gift of income be in form accomplished by the temporary disposition of the donor's property which produces the income, the donor retaining every other substantial interest in it, we have not allowed the form to obscure the reality. Income which the donor gives away through the medium of a short term trust created for the benefit of the donee is nevertheless income taxable to the donor. *Helvering* v. *Clifford, supra; Hormel* v. *Helvering,* * * * [312 U. S. 552]. We perceive no difference, so far as the construction and application of the Revenue Act is concerned, between a gift of income in a specified amount by the creation of a trust for a year, see *Hormel* v. *Helvering, supra,* and the assignment by the benefici-

ary of a trust already created of a like amount from its income for a year.

Continuing the Court said (p. 583):

> Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable interest in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or a part of it for the period of a year as in this case. "Drawing the line" is a recurrent difficulty in those fields of the law where differences in degree produce ultimate differences in kind. * * *. It is enough that we find in the present case that the taxpayer, in point of substance, has parted with no substantial interest in property other than the specified payments of income which, like other gifts of income, are taxable to the donor.

The District Court which tried the present case followed the reasoning of the Supreme Court's opinion in the *Schaffner* case and concluded that Laura D. Sherman the assignor and taxpayer in the instant case retained the entire reversionary interest in the assigned income, and that this reversion, representing as it does a substantial economic interest in the Sherman trust, requires the inclusion of the assigned income as part of the taxable gross income of the assignor. (R. 50.) But the taxpayer argues that while each of the assignments was a substantial disposition of the particular interest of Mrs. Sherman in the trust dated December 26, 1935, the reversionary interest of Mrs. Sherman in the interests so transferred was not substantial, and that the trial court erred in finding and deciding that her reversionary interest was a substantial economic interest in that trust. (Br. 9.) And, at the conclusion

of its arguments, the taxpayer again repeats the argument that the assignments were substantial. (Br. 20-21.) Now, we submit, if the assignments of income were substantial dispositions, it must follow *a fortiori* that the right to have this income back at the termination of the assignments consituted a substantial economic reversionary interest. By the same token, if these assignments effected a substantial economic equitable interest in the principal of the trust, then the assignor's reversionary interest likewise constituted a comparable economic interest. So, we submit that the District Court was correct in finding and deciding that Mrs. Sherman's reversionary interest was a substantial economic interest in that trust. Accordingly, we believe the District Court's decision should be affirmed.

The taxpayer's position seems to stem from the erroneous premises that the termination of the assignments was dependent upon contingencies beyond any control of the assignor, and that the fact that the assignments could terminate prior to the deaths of the assignees is not significant. (Br. 15.) That reasoning ignores the important fact that, by providing for the termination of the assignments upon such contingencies, the assignor indisputably expressed her intention not to dispose of her full life interest in the trust. Even if it were reasonable to assume that Mrs. Sherman would probably predecease the assignees (Br. 16), we think that such a probability is immaterial to the determination of the issue here involved. The important fact is that by the language used to designate the periods of each assignment Mrs. Sherman did not in any way indicate an intention to dispose of her entire life estate or to dispose of any interest in the trust co-extensive with her own life. That she did not so intend is manifested by the fact, as the taxpayer admits (Br. 16) that the assignments were tailored to fit exactly the require-

ments of the divorce decree. Since the events so designated could have happened, and in the case of the children apparently did happen before Mrs. Sherman died, we submit that the taxpayer's argument that (Br. 16)—

> for practical purposes it was the substantial equivalent of a transfer for the life of Mrs. Sherman, * * *

is just plain sophistry. An inspection of the instruments of assignment will disclose that Mrs. Sherman assigned only a part of the income otherwise distributable to her for periods less than the duration of her life, retaining the right to have that income at the termination of the designated periods. She merely assigned a *fixed amount* monthly from the income that she was entitled to receive. These assignments, being for periods less than the duration of the assignor's life and *not constituting her entire interest in the trust,* clearly did not represent a substantial interest *in the trust property* other than the specified payments of income which, like other gifts of income, are taxable to the donor. *Harrison* v. *Schaffner*, 312 U. S. 579, 583. The possibility that she might die before the happening of the termination events provided in the instruments certainly did not impart to the assignments characteristics which made them substantially equivalent to transfers for Mrs. Sherman's life. If it is proper to regard Mrs. Sherman's assignments as transfers for her life, then by the same token, the yearly assignments in the *Schaffner* case should have been so regarded because even for such a short period the assignor could have died before the expiration of the year. But as the Supreme Court did not so regard those assignments in the *Schaffner* case, there is no logical reason for regarding Mrs. Sherman's assignments as made for her life. In every case where a life beneficiary of a trust makes an assignment

of income, it must terminate with the assignor's death. It would open the door to tax avoidance if such an absurd interpretation were placed upon all assignments of income by life beneficiaries. The Supreme Court's opinion in the *Schaffner* case effectually closes the door to such legal chicanery.

Neither does the possibility that these assignments might extend for a period of ten years exclude them from being categorized as assignments of short duration. The taxpayer's argument (Br. 16-17) appears to be predicated on the erroneous premise that the period of the assignment made by Mrs. Sherman was for a period of ten years, and cites in support of its argument the case of *Commissioner* v. *Jonas,* 122 F. 2d 169 (C. C. A. 2d), which involved the taxability of the income of two trusts were each limited to a period of ten years, but which were further extended prior to expiration from time to time. The *Jonas* case is clearly distinguishable on its facts from the instant case. That case involved the taxability to the settlor of the income of two trusts, which was payable to her two sons. The instant case does not involve the taxability of trust income to the settlor, but the taxability to the life beneficiary of trust income, part of which she assigned to others for limited periods less than for the duration of her life. Unlike the taxpayer in the *Jonas* case, Mrs. Sherman was a co-trustee of the trust in which she was a life beneficiary, and as co-trustee had the following powers (R. 15-16):

> 5. The Trustees shall have full power and authority to manage and control the property from time to time included in said trust estate, to sell at public or private sale, to exchange, to borrow, to pledge, and to invest and reinvest. It is expressly provided that the Trustees shall have the right and power to invest any moneys at any time or from

time to time in their hands in common stocks and preferred stocks of corporation organized under the laws of the Territory of Hawaii or elsewhere in the United States of America and shall not be limited by any statute or rule of law to the contrary. The Trustees shall treat all stock dividends and rights to subscribe as principal, and all cash dividends, whether regular or extraordinary, unless paid out of capital, as income. The Settlor expressly declares that the shares of corporation capital stock hereby assigned by him to the Trustees have proved satisfactory investments during a considerable period of time and that he does not wish them sold unless the Trustees in their discretion shall think it clearly advisable because of changing conditions or other special reasons. The Trustees shall not be held liable for any loss to the trust estate resulting from the retention of said stock by them.

Notwithstanding the settlor's declaration that he did not wish the securities sold, he did not close the door against their sale if deemed advisable. So, it may not be denied that Mrs. Sherman, as co-trustee, did have control over the income of the trust, and might have exercised that control so as to change the amount of income payable to her assignees, thus bringing her assignments within the rule of *Helvering* v. *Clifford,* 309 U. S. 331.

The taxpayer quotes (Br. 18-20) the dissenting opinion of Judge Arundell of the Tax Court in the case of *Farkas* v. *Commissioner,* 8 T. C. 1351, 1358, further in support of its contention that all the errors which the taxpayer attributes to the court below stem from a misconception of the rationale of the *Schaffner* case, *supra.* But we invite this Court to read the majority opinion in the *Farkas* case for an able rationalization

of the applicability of the rule of the *Horst* and *Schaffner cases,* to assignments of income by life beneficiaries of trusts comparable to that made by Mrs. Sherman in this case.

In the *Farkas* case the Tax Court very clearly points out why a person should be taxed upon the income which he assigns, when, as here, he retains the right to have that income at the termination of the assignment, which, as here, is for a period less than his life.

There is nothing in the courts' opinions in the case of *Hyman* v. *Nunan,* 143 F. 2d 425 (C. C. A. 2d), and the case of *Mahaffey* v. *Helvering,* 140 F. 2d 879 (C. C. A. 8th), cited on page 15 of the taxpayer's brief, contrary to the Collector's position here. Neither is the District Court's opinion in *Belknap* v. *Glenn,* 55 F. Supp. 631 (W. D. Ky.) (Br. 15), at variance with the Collector's position here. Similarly the opinion in *Huber* v. *Helvering,* 117 F. 2d 782 (App. D. C.) (Br. 15), supports the Collector's position here.

B. The decision in the Blair case is not opposed to the Collector's position here

The decision in the *Blair* case is not opposed to our position here. There, the life beneficiary of a trust irrevocably assigned a substantial portion *of his entire equitable life estate.* Accordingly, in that case the assignment of income was co-extensive with the assignor's entire estate in point of time as to the part thereof assigned. In the instant case this is not true. Here there was no transfer of any part of the assignor's life estate, but only of a specified number of dollars of income to which the assignor would be entitled if and when that amount of income might be earned by the trust. We think that the distinction mentioned is vital, and because of it, the decision in the *Blair* case is not opposed to our position here and is not controlling in the present case.

Such circumstances as those in the *Blair* case afforded basis for a holding that the assignor there did not retain enough of those prerequisites of ownership which the Supreme Court in *Helvering* v. *Clifford*, 309 U. S. 331, held to be determinative of tax liability. The situation here is materially different. Laura D. Sherman's equitable life estate in her husband's trust property was not assigned to anyone, in whole or in part; instead she merely carved out of that estate only a portion of the income, retaining the entire reversionary interest in the income so assigned upon the happening of designated events, all of which could occur in her lifetime. Thus her interest in the life estate remained intact after, as it was before, the assignment, wholly unaffected by it. There was no diminution of the interest of this beneficiary resulting from an assignment of a specified amount of the income which might be earned by the trust in a particular year and to which she was entitled.

If any of the assignees here received an interest in the Sherman trust which would entitle such assignee to enforce his or her rights as an owner of a beneficial interest in that trust as contradistinguished from merely the right to receive a certain number of dollars from the trustees if and when they were earned, the results would prove very perplexing indeed. For example, if for the year 1940 the taxpayer assigned an interest in the trust estate measured by $3,000 of income in that year, then, if the assignees learned that the trustees contemplated changing the investments of the trust in such a way that the income thereof for the year 1940 would not amount to more than $2,000, we submit that there is nothing the assignees could do to interfere with the trustees changing the investments of the trust. If the taxpayer's position is correct, the assignees would have the right to demand and require

that the trustees wholly disregard the effect upon trust income of the changed investments and make up the deficiency in income out of corpus. But it seems indisputable that the assignees did not acquire such an interest in the trust. It would seem therefore that the mere statement of such a proposition should refute the contentions of the taxpayer and demonstrate the fallacy of the taxpayer's argument that the assignees received an interest in the corpus of this trust by virtue of and as the result of the assignments in question. Thus there is only one other alternative right which inured to the assignees and that was only the right to enforce payment to them of the amounts of income provided in the assignments if and when that income was actually earned.

The instant case is more like the *Schaffner* case, *supra,* where the taxpayer carved out of her life estate a single year's income only. True, the assignees in the instant case had the right to receive income for a period which possibly might extend beyond a year, and in the case of the children, for as long as possibly ten years, but we submit that difference is merely one of degree, which, we believe, should not produce a difference in result taxwise. In any event, we believe the decision in the *Blair* case, *supra*, should be no more controlling here than it was in the *Clifford* and *Schaffner* cases. As we have hereinbefore pointed out, unlike the taxpayer in the *Blair* case, the taxpayer here did not assign to the assignees for her life all of her future interest in the income of the trust of which she was the sole life beneficiary. Instead, she merely assigned a specified number of dollars of that income for different periods not co-extensive with her life but which could have terminated before her death and, in the case of the children, did so terminate before her death. The *Blair* case limits the application of the doctrine of the

Schaffner and *Horst* cases only to the extent that a grant by the life beneficiary of her full interest in the income consists of a gift of the equitable interest in the corpus as well as of the income. As the Tax Court said in the case of *Farkas* v. *Commissioner,* 8 T. C. 1351, 1357:

> The underlying reason why a gift of income unaccompanied by the gift of the property producing the income is ineffective to relieve the donor from the tax rests on the principle "that the power to dispose of income is the equivalent of ownership of it, and that the exercise of the power to procure its payment to another, whether to pay a debt or to make a gift, is within the reach of the statute, taxing income 'derived from any source whatever' ".

The underlying reasoning in the cases relied upon by the Collector is that income is realized by the assignor because she, who owns or controls the source of the income, also controls the disposition of that which she could have received herself and diverts the payment from herself to others as a means of procuring a satisfaction of her wants. In other words the assignor has thus obtained the satisfaction of her desires where she collects and uses the income to procure those satisfactions or where she disposes of her right to collect it as a means of procuring them. In *Corliss* v. *Bowers,* 281 U. S. 376, 378, the Supreme Court said:

> The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

Cf. *Helvering* v. *Eubank,* 311 U. S. 122. In the instant case each of the instruments making the assignments

contains a gift of a definite monthly sum to be paid (R. 43, 44)—

> from the income to which the assignor now is or shall be entitled to receive as life beneficiary under the terms and provisions of that certain unrecorded trust deed dated December 26, 1935, executed by George Sherman as settlor * * *.

Following the rationale of the District Court's opinion in *Bing* v. *Bowers*, 22 F. 2d 450 (S. D. N. Y.), affirmed without opinion, 26 F. 2d 1017 (C. C. A. 2d), no title to the trust estate or to any interest therein was created by the assignments, and the entire net income of the trust estate became gross income of the assignor notwithstanding the assignments of a part thereof to others.

C. The taxing statutes fixes accountability for the tax upon the taxpayer because of her status as life beneficiary of the trust

The internal revenue law itself, we submit, points to the correct solution of the instant problem. It deals explicitly with the liability of the estate or trust and reveals clearly where Congress intended to impose responsibility for the tax. Section 161(b) o fthe Internal Revenue Code (Appendix, *infra*) provides:

> The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary * * *.

Section 162(b) of the Internal Revenue Code (Appendix, *infra*) provides:

> There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries * * * but the amount so allowed as a deduction shall be included

> in computing the net income of the beneficiaries * * *.

Since a tax statute is here involved, the import and reasonable construction thereof are controlling. The statute here is plainly worded. It imposes the liability for the tax on the beneficiary receiving trust income. No liability is placed upon her assignees, and, though they may have enforceable rights against the assignor in courts of equity, the taxing statute points unmistakenly to the beneficiary as the one answerable for the tax. Thus, for tax purposes the taxpayer's status in he present proceeding as beneficiary of the trust dated December 26, 1935, is unalterably fixed. Even if equity may regard the assignment in this case as extinguishing the taxpayer's rights *in rem* as equitable owner of the trust *res* or her rights in *personam* against the trustee, the tax statute, nevertheless, fixes the accountability for the tax upon the taxpayer because of her status as beneficiary. So, even if it is assumed that the daughter-in-law and the children became beneficial owners of part of the income which the taxpayer received from the trust, it is still true that she, and not they, was the beneficiary of the trust, and that they had only a *derivative* interest. The very assignments in this case are bottomed on the fact that the income was the taxpayer's property, else there would have been nothing on which they could operate. Cf. *Poe* v. *Seaborn*, 282 U. S. 101.

It is, therefore, immaterial whether the law considers an equitable interest for life or for a term of years as present property, alienable like any other. Even though a beneficiary's interest is alienable, assignments of income are ineffective for tax purposes. It is clear from a reading of the assignments here involved that they dealt only with a right to receive income, and no

attempt was made to assign an equitable right, title or interest in the trust itself. The pertinent language of each assignment reads as follows (R. 43):

> * * * the undersigned, Laura D. Sherman, hereinafter referred to as the assignor, does hereby assign, transfer and set over unto * * * [name of donee], hereinafter referred to as the assignee, the sum of * * * a month from the income to which the assignor now is or shall be entitled to receive as life beneficiary under the terms and provisions of that certain unrecorded trust deed dated December 26, 1935, * * *.

Thus, in substance, the assignments are powers of attorney to receive the income to which the taxpayer "now is or shall be entitled to receive." When the assignees collect under these instruments, they do not collect their own income. By the terms of the instruments they are to collect the income due to the taxpayer.

CONCLUSION

The judgment of the District Court is correct and in accordance with the law and authorities. It should therefore be affirmed upon review of this Court.

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September, 1948.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.

* * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary * * *.

* * *

(26 U. S. C. 1946 ed., Sec. 161.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall

not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

* * *

(26 U. S. C. 1946 ed., Sec. 162.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.22(a)-1. *What Included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. * * *

Sec. 19.161-1 [as amended by T. D. 5194, 1942-2 Cum. Bull. 53]. *Imposition of the tax.*—(a) *Scope.*—Supplement E (sections 161 to 171, inclusive) prescribes that the taxes imposed upon individuals by chapter 1 shall be applicable to the income of estates or of any kind of property held in trust. The rate of tax, the statutory provisions respecting gross income, and, with certain exceptions, the ply also to estates and trusts.

The several classes enumerated and described in the four paragraphs of sction 161(a), and which are introduced by the word "including," do not exclude others which also may come within the general purpose of that subsection.

The several classes enumerated and described in the four paragraphs of section 161(a), and which are introduced by the word "including," do not exclude others which also may come within the general purpose of that subsection.

A guardian, whether of an infant or other person, is a fiduciary (see section 3797(a) (6)), and,

as such, is required to make and file the return for his ward and pay the tax, or the return may be made by the ward. (See section 19.51-1 and 19.142-2.) The estate of a ward is not a taxable entity, in that respect differing from the estate of a deceased person or of a trust.

The provisions of sections 161, 162, and 163 (relating to estates and trusts, fiduciaries, and beneficiaries) contemplate that the corpus of the trust, or the income therefrom, is, within the meaning of the Internal Revenue Code, no longer to be regarded as that of the grantor. If, by virtue of the nature and purpose of the trust, the corpus or income therefrom remains attributable to the grantor, these provisions do not apply. Thus the provisions of sections 166 and 167 deal with certain trusts which are excluded from the scope of sections 161, 162, and 163. Other trusts, not specified in sections 166 and 167, where in contemplation of law the corpus of the trust or the income therefrom is regarded as remaining in substance that of the grantor are likewise excluded from th scope of sections 161, 162, and 163. Some of such trusts are dealt with in sections 19.166-1 and 19.167-1. So-called alimony trusts to which section 22(k) or section 171 applies may be of a type to which the provisions of sections 161, 162, and 163 also apply, or of a type which is excluded from the provisions of sections 161, 162, and 163. Except to the extent that section 22(k) or section 171 governs the taxability of amounts paid, credited or to be disribued attributable to trust property, the treatment of such trusts under sections 161, 162, and 163 or under sections 166 and 167 is not affected by section 22(k) or section 171. See section 165 as to the exemption of employees' trusts.

(b) *Taxability of the income.*—The fiduciary is required to make and file the return and pay the tax on the net income of the estate or trust except as otherwise provided in sections 165, 166, and 167, and sections 19.166-1 and 19.167-1. In determining whether there is any net income subject to tax and the amount thereof, consideration is to be given to the additional deductions authorized in section 162.

Sec. 19.162-1 [as amended by T. D. 5196, 1942-2 Cum. Bull. 96, and T. D. 5215, 1943 Cum. Bull. 70]. *Income of estates and trusts.*—In ascertaining the tax liability of the estate of a deceased person or of a trust, there is deductible from the gross income, subject to exceptions, the same deductions which are allowed to individual taxpayers. Se generally section 23, and the provisions thereof governing the right of deduction for depreciation and depletion in the case of property held in trust. Amounts allowable under section 812(b) as a deduction in computing the net estate of a decedent are not allowed as a deduction under section 23, except subsection (w), in computing the net income of the estate unless there is filed in duplicate with the return in which the item is claimed as a deduction a statement to the effect that the items have not been claimed or allowed as deductions from the gross estate of the decedent under section 812(b) and a waiver of any and all right to have such item allowed at any time as a deduction under section 812(b). For items not deductible, see section 24. Against the net income of the estate or trust there are allowable certain credits, for which see sections 25 and 163.

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

* * *

(b) Any income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to a legatee, heir, or beneficiary, whether or not such income is actually distributed. For this purpose, it is provided in section 162(b), as amended by the Revenue Act of 1942, that "income which is to be distributed currently" includes income of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary.

(c) Any income of the estate of a deceased person for its taxable year which is property paid or credited during such year to a legatee or heir, and any income either of such an estate or of a ~~deductions and credits allowed to individuals ap-~~ trust for its taxable year which is similarly paid or credited during that year to a legatee, heir, or beneficiary if there was vested in the fiduciary a discretion either to distribute or to accumulate such income.

* * *

Any amount described in (b) and (c) of this section of the regulations as being deductible from the gross income of the estate or trust shall be included in computing the net income of the legatees, heirs, or beneficiaries, whether distributed to them or not.

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